In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1973

No. 73-641

EDWIN A. SNOW and HELEN B. SNOW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BURGESS L. DOAN
HAROLD W. WALKER
522 Dixie Terminal Building
Cincinnati, Ohio 45202
Counsel for Petitioner

COURT INDEX PRESS, INC. — 809 Walnut Street, Cincinnati, Ohio 45202 — (513) 241-1450

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The Petitioners, EDWIN A. SNOW and HELEN B. SNOW, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on July 17, 1973.

OPINIONS BELOW

A. The opinion of the Court of Appeals, not yet reported, appears in the appendix hereto.

B. The opinion of the United States Tax Court, reported at 58 T.C. No. 60 (June 30, 1972), also appears in the appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on July 17, 1973, and this petition for certiorari was filed within ninety (90) days of that date. This Court's jurisdiction is invoked under 28 U.S.C. Section 1254 (1).

QUESTION PRESENTED

1. Whether a business is entitled to deduct research and experimental expenses incurred in the development of its initial product.

STATUTORY PROVISIONS INVOLVED

Sec. 174. RESEARCH AND EXPERIMENTAL EXPENDITURES

"(a) Treatment as Expenses –

"(1) In General. – A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

"(2) When Method May Be Adopted –

"(A) Without Consent. – A taxpayer may, without the consent of the Secretary or his delegate, adopt the method provided in this subsection for his first taxable year –

"(i) which begins after December 31, 1953, and ends after the date on which this title is enacted, and

"(ii) for which expenditures described in paragraph (1) are paid or incurred.

"(B) With Consent. — A taxpayer may, with the consent of the Secretary or his delegate, adopt at any time the method provided in this subsection.

"(3) Scope. — The method adopted under this subsection shall apply to all expenditures described in paragraph (1). The method adopted shall be adhered to in computing taxable income for the taxable year and for all subsequent taxable years unless, with the approval of the Secretary or his delegate, a change to a different method is authorized with respect to part or all of such expenditures."

STATEMENT OF THE CASE

This case involves deficiencies asserted in federal income taxes for the taxable year 1966 in the amount of $6,247.00. The deficiency involved is attributable to an adjustment disallowing as a deduction Petitioner Snow's[1] distributive share of a net operating loss of a partnership d/b/a Burns Investment Company ("Burns").

Burns reported a net operating loss in the amount of $36,780.44 on its 1966 federal income tax return (Form 1065) of which Snow's distributive share was $9,195.00. This loss arose as a result of the partnership incurring and

[1] Helen B. Snow is also listed as petitioner herein solely because she and Mr. Snow filed a joint return in 1966.

paying expenses in connection with research and development of a new product.

The Commissioner of Internal Revenue determined that the research and development expenses were not allowable to Burns under Section 174 or any other section of the Internal Revenue Code.

The United States Tax Court sustained the Commissioner, holding:

> "The expenditures for research and experimentation were not paid in connection with the trade or business of the partnership, or of Snow, and are not deductible under Section 174." (Appendix, p. 13)

The United States Court of Appeals for the Sixth Circuit sustained the Tax Court's decision:

> ". . . we hold that the expenditures sought to be deducted by Burns Investment Company in 1966 were 'pre-operating' expenses and are not deductible under Section 174." (Appendix p. 40)

The facts involved are not complex and may be briefly stated.

In 1966, a limited partnership d/b/a Burns Investment Company was formed in Cincinnati, Ohio. The partnership consisted of one general partner, D. H. Trott, and several limited partners, of whom Snow was one. Snow, who at that time was an executive with The Procter & Gamble Co. in Cincinnati, invested $10,000 in Burns. (Snow had previously joined with Trott in the formation of two other limited partnerships, Echo Development Company in 1965, and Courier Enterprises in 1965. Both had also been formed to develop and market new products, a telephone answering device ("Echo") and an electronic tape recorder ("Courier"). Although "Echo" and "Courier" also claimed deductions for Section 174 expenditures,

the Commissioner chose only to challenge the expenditures claimed by "Burns." Presumably this discrepancy in treatment was motivated by the fact that "Echo" and "Courier" both had products which were in a more advanced stage of development and which were then held available for sale or licensing.)

Burns was organized to further develop and perfect a leaf and/or trash burner. Trott, the inventor and general partner, had conceived the idea for the trash burner sometime in 1964. He had made and tested a number of prototypes between 1964 and 1966. In December of 1965, he received advice from patent counsel that there were several features which were patentable. In early 1966, however, he was advised that the burner as a whole had not been sufficiently perfected to be patented and that additional work would be necessary to modify the model so that it could become a marketable product.

In order to secure the funds necessary for this further modification and development, Trott, in July of 1966, formed Burns Investment Company. Snow and two other limited partners contributed the capital; Trott contributed all right, title, and interest in the trash burner. During the period between July 1, 1966 and December 31, 1966, Burns paid a total of $36,780.44 for development work on the burner. There is no dispute as to the amount claimed or as to the fact that these expenses were incurred for research and development purposes.

During the year 1966, Burns reported no sales of the trash burner or of any other product. The burner was still in the process of being perfected and was simply not yet marketable.

In the succeeding years (which are not in issue here) the development of the burner continued. An application for a patent was filed on June 10, 1968. A patent was

issued on March 3, 1970, to Trott, the general partner. Prior to 1970, Burns was incorporated under the name of Burns Investment Corporation to produce and market the trash burner under the trade name "Trash-Away." Snow has continued to participate in the venture and has served Burns Investment Corporation, since its incorporation, as Chairman of the Board. The "Trash-Away" is currently being produced and marketed by Burns Investment Corporation.

REASONS FOR GRANTING WRIT

1. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS AS TO THE PROPER INTERPRETATION OF 26 USC SECTION 174.

Petitioner Snow, in the proceedings below, relied heavily upon the Fourth Circuit case of *Cleveland* v. *Commissioner*, 297 F 2d 169 (4th Circuit, 1961). In *Cleveland*, an attorney (Cleveland) who was interested in experiments carried on by one of his clients (Kerla), began to lend Kerla financial assistance. Kerla was involved in trying to develop a new type of liquid binder. Shortly after the enactment of Section 174, a formal trust agreement was entered into whereby Cleveland purchased a participating one-half interest in the invention for the past loans. In 1955 and 1956, Cleveland took deductions under Section 174 for funds advanced subsequent to the agreement attributable to research and development. *Cleveland's* facts do not indicate that the binder was ever actually marketed or that any patent was ever applied for. The Commissioner and the Tax Court held that these advances were not deductible. The Court of Appeals for the Fourth Circuit reversed the Tax Court holding:

> "In this instance the decision of the parties to the agreement to define their relationship so as to take advantage of the benefits of the statute was in harmony with the purpose of the enactment to encourage expenditures for research and experimentation." (at page 171)

The Sixth Circuit, however, chose not to follow *Cleveland*, stating:

> "We are by no means certain that *Cleveland* involved any dispute over whether the joint enterprise therein concerned was engaged in a trade or business. If, however, it be read as in conflict with our view in this case, we prefer the logic of the later Fourth Circuit holding in *Richmond Television Corp.* v. *United States*, 345 F 2d 901, (4th Cir., 1965), to the Fourth Circuit's earlier holding in *Cleveland*." (Appendix, p. 40)

Given the similarity between the facts of the two cases, Snow respectfully submits that there can be no doubt that *Cleveland* and *Snow* are in conflict. In each case an investor (Cleveland and Snow) supplied the capital so that an inventor (Kerla and Trott) could continue to develop a new product. In both cases the product was not yet marketable at the time of the investment. In neither case did the partnership (*Snow*) or joint venture (*Cleveland*) have an established trade or business in another field of endeavor. In both cases the deductions were claimed under Section 174. In *Cleveland*, the Fourth Circuit allowed these deductions. In *Snow*, the Sixth Circuit disallowed these deductions.

Snow contends, furthermore, that the Sixth Circuit's statement, supra, that it preferred the Fourth Circuit's later holding in *Richmond Television* does nothing to reconcile this conflict. Snow points out that *Richmond*

Television involved the disallowance of a deduction claimed under Section 162 of the 1954 Internal Revenue Code rather than Section 174. The Fourth Circuit, in deciding *Richmond,* surely was not aware that it was in any way overruling, qualifying, or even refining their *Cleveland* decision. A reading of *Richmond* shows that that case never so much as mentions the *Cleveland* case. This omission seems quite proper since the issue in *Richmond* was whether "start-up" expenses were "ordinary and necessary" and, therefore, deductible under Section 162. *Cleveland* and *Snow,* on the other hand, concern the deductibility of research and experimental expenses under Section 174.

Cleveland, therefore, remains to be the leading "Section 174 case" in the Fourth Circuit. The *Snow* decision thus creates a decided conflict between the Fourth and Sixth Circuits.

In addition to this Circuit conflict, a reading of Tax Court decisions dealing with Section 174 reveals a decided lack of consistency in the courts' interpretations of that section. A decision by this Court in this area would, therefore, be extremely helpful in insuring that taxpayers in different sections of the country will receive the uniform treatment which is vital to the administration of a just revenue system.

2. THE DECISION BELOW RAISES SIGNIFICANT AND RECURRING PROBLEMS CONCERNING EFFORTS OF SMALL AND BEGINNING BUSINESSES TO INVOKE SECTION 174 OF THE INTERNAL REVENUE CODE OF 1954. IN ADDITION, THE DECISION BELOW IS ONE OF MAJOR IMPORTANCE IN THAT IT STRONGLY TENDS TOWARD FOSTERING BIG BUSINESS WHILE INHIBITING SMALL, NEWLY-ORGANIZED COMPETITION.

Section 174 was intended to be a liberalizing provision to allow expenditures which otherwise would have to be capitalized to be deductible in the year incurred. The legislative history of Section 174 indicates a broad purpose to provide an economic incentive, especially for small and growing businesses, to engage in the search for new products and new inventions. The measure was initially introduced in Congress in 1951 "to clarify the existing confusion in respect of tax treatment of such expenditures, and to prevent tax discrimination between large businesses having continuous programs of research and small or beginning enterprise." 97 Cong. Rec. 4326A (1951). (Extension of Remarks of Representative Comp.) The remarks of Mr. Reid of New York, Chairman of the House Committee on Ways and Means addressed to the House during consideration of the H. R. 8300, the Bill embodying the Internal Revenue Code of 1954, indicates the broad purpose of Section 174 as finally enacted:

> "Research and Development expenditures: Present law contains no statutory provisions dealing with the deduction of these expenses. The result has been confusion and uncertainty. Very often, under present law, small businesses which are developing new products and do not have established research departments are not allowed to deduct their expenses despite the

> fact that the large and well-established competitors can obtain the deduction . . . This provision will greatly stimulate the search for new products and the new inventions upon which the future economic and military strength of a Nation depends. It will be particularly valuable to small and growing businesses." 100 Cong. Rec. 3425 (1954).

A small business like Burns whose entire energies are devoted to a product development effort would seem to be precisely the kind the company Congress sought to bring within the reach of Section 174. The decision by the Sixth Circuit in *Snow,* however, makes that section unavailable to this type of business, while preserving its availability to "large and well-established competitors."

The Sixth Circuit held in *Snow* that the research and development expenditures incurred by Burns were not deductible because "as of 1966 it (Burns) had no product to offer." (Appendix, p. 38) In reaching this conclusion, the Sixth Circuit placed heavy emphasis upon a number of established cases dealing with Section 162 of the 1954 Code, notably *Deputy* v. *Dupont,* 308 U.S. 488 (1940) and *Richmond Television,* supra. These cases focus on the "existing sales" vs. "pre-operating expenses" tests to decide the availability of Section 162 deductions. The legitimacy of deciding a Section 174 case by using tests articulated in the context of a different Code Section is a matter of critical importance to the question presented in this petition.

Section 162 allows deductions for expenses which are "ordinary and necessary in carrying on a trade or business." The phrase "carrying on a trade or business" has been in statutory existence since 1928, first as 23 (a) of the Internal Revenue Code of 1928, today as 162 (a) of the 1954 Code. It is, therefore, reasonable to assume that Congress was well aware of its existence, and yet Congress chose to use

a different phrase — "in connection with its trade or business" — for the purposes of Section 174. Section 174, neither in the Code itself nor in the Regulations promulgated thereunder, makes any reference to Section 162. Had Congress wished the two sections to be construed in the same manner, it would have been a simple matter to so indicate. In contrast to Section 174, there are other code sections and regulations which do make specific reference to the requirements of Section 162. See, for example, Regulation 1.512 (a) -1 (b).

The use of Section 162 tests to decide Section 174 cases is even less justified when one considers the purposes behind the two sections. For while the "prepatory" vs. "existing" test seems both logical and proper in terms of "ordinary and necessary" business expenses (Section 162), it is illogical on its face when applied to "reasearch and development" expenses (Section 174). Surely the statutory phrase "research and development" presupposes a product which is not yet in a marketable condition, and yet the Sixth Circuit insists on existing sales of the product in order to qualify research expense deductions.

The practical results of the Sixth Circuit's interpretation of Section 174 can be easily seen. An established company with existing sales of a given product may refine and improve that product through research and experimentation and be permitted to deduct the costs of such research. An established company with existing sales of any given product may attempt to develop a completely new product or idea and will be permitted to deduct the costs of such development. (See *Best Universal Lock Co.*, 45 T.C. 1 (1965), acq. 1966-1 Cum. Bull. 1) A new company with a new idea such as "Burns," however, is unable to deduct these expenses.

The "existing products test," therefore, clearly discriminates against companies formed to develop new products

and works to the advantage of companies with existing products. The construction of Section 174 adopted by the Sixth Circuit would tend to foster and perpetuate monopoly by frustrating the development of inventions or improvements by newly-organized competitors of established businesses. American Economic History gives ample testimony to the importance of a business which begins with only a new and ingenious idea. Polaroid and Xerox are examples of enterprises organized to develop new ideas which were initially rejected by established companies.

Section 174 was originally enacted as an aid to the growth and development of small, new businesses like Burns. The decision below by the Sixth Circuit completely contradicts that purpose by making Section 174 available only to established companies. Petitioner Snow begs this Court to take the opportunity presented by this case to announce a construction of Section 174 which is in harmony with the section's intent.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Sixth Circuit.

Respectfully submitted,

BURGESS L. DOAN
HAROLD W. WALKER
522 Dixie Terminal Building
Cincinnati, Ohio 45202
Counsel for Petitioner

APPENDIX

[CCH Dec. 31,449]

EDWIN A. SNOW AND HELEN B. SNOW v. COMMISSIONER

Docket No. 7125-70. 58 TC—, No. 60.

Filed June 30, 1972. Cincinnati, Ohio.

[Code Sec. 174(a)]

[Business expenses: Research and experimentation: Existence of business v. preparatory costs.] Snow, an executive in a large corporation, invested money and gave advisory services in three limited partnerships formed in 1965 and 1966, each to carry on research and experimentation upon a particular invention with a view to profit. In 1966 two of the inventions were held for licensing to manufacturers but none were so licensed in that year. The third invention, a trash burner, was not sufficiently developed to be ready for sale or licensing in 1966. The partnership developing this invention had no income in 1966 but reported a net loss by reason of a deduction claimed under section 174 (a), I. R. C. 1954, for expenditures for research and experimentation. Snow claimed his pro rata share of such loss for 1966.

Held: The expenditures for research and experimentation were not paid in connection with the trade or business of the partnership or of Snow, and are not deductible under section 174. *John F. Koons* [Dec. 24,760], 35 T. C. 1092 (1961).

Harold W. Walker, and Burgess L. Doan, 522 Dixie

Terminal Bldg., Cincinnati, Ohio, for the petitioner. Rudolf L. Jansen, for the respondent.

BRUCE, Judge: Respondent determined a deficiency of $6,247 in the income tax of the petitioners for the calendar year 1966. Edwin A. Snow was a member of a partnership which reported a net loss for 1966 by reason of a deduction claimed under section 174, Internal Revenue Code of 1954, for expenditures for research and experimentation. Respondent disallowed the pro rata share of such loss claimed by the petitioners. The sole issue for decision is whether such expenses are properly deductible. Some facts are stipulated.

Findings of Fact

The stipulation of facts and the exhibits attached thereto are incorporated by reference.

Edwin A. Snow and Helen B. Snow are husband and wife. They filed a joint Federal income tax return for the calendar year 1966 on the cash basis with the district director of internal revenue at Cincinnati, Ohio. They were residents of Cincinnati on the date of the filing of the petition herein.

Edwin A. Snow is a graduate of Stanford University and Harvard Graduate School of Business. He holds degrees of B. A. in Economics and M. A. in Business Administration. He took no engineering courses and has never applied for a patent. He has been employed by Procter & Gamble Company since 1933. His work was in advertising and marketing and later in management. In 1966 he was executive vice president and a member of the Board of Directors of Procter & Gamble.

David H. Trott was an employee of Procter & Gamble Company for 22½ years, resigning in 1963. His work was

in advertising and marketing and general management. He has been acquainted with Snow since about 1942. He holds a degree of B. A. in Liberal Arts. He has no degree in engineering. He had no training or experience in engineering prior to 1963.

In 1964 Trott bought a 25 percent interest in Crossbow, Inc. The other stockholders were Robert Boggild and William Dale. This corporation did shop work in machine and fabricating. It had some 25 customers for whom shop work was done. It occupied a building at 8120 Blue Ash Road, Cincinnati, which had 5,000 square feet of floor space on the ground floor, a basement of 4,000 square feet, and various items of shop and manufacturing equipment. On the main floor 1,000 square feet were separated for office and designing work. Later Trott owned a 50 percent interest in Crossbow and in December 1965 became sole owner.

At the time Trott acquired an interest in Crossbow his associates were experimenting upon a telephone answering device. Trott took part in developing the project further. Trott had conceived the idea of a tape recording device and the engineers and employees of Crossbow worked on that project. Trott had also conceived the idea of a leaf burner or trash burner and Crossbow's employees worked at making models of that for experiment and development.

In March 1965 Snow and certain others agreed to invest funds in the research and development of the telephone answering device and the tape recording device upon which Trott and his associates were conducting experiments. A certificate of limited partnership under the laws of Ohio was signed by Trott, Boggild and Dale, as general partners, and George L. Sterne, Edwin A. Snow, Trustee, Edward J. Noble, L. S. Brucker, Jr., Trustee, and Eugene W. Gilson, as limited partners, under the name "Echo Development Company" to develop the telephone answering

device. Sterne contributed all right, title and interest to the product concept. Snow, Noble, Brucker and Gilson each contributed $15,000. Trott and Sterne were each to have a 20 percent interest in the profits. The others were each to have a 10 percent interest. The principal place of business was to be at 8120 Blue Ash Road, Cincinnati.

A certificate of limited partnership under the laws of Ohio was also signed in March 1965 by Trott, Boggild and Dale as general partners, and Snow, Trustee, Noble, Brucker, Trustee, and Gilson as limited partners to be conducted under the name of "Courier Enterprises." This was to develop the tape recording device. The limited partners each contributed $5,000 in cash. Trott was to have a 40 percent interest in the profits, the other partners were each to have a 10 percent interest. The principal place of business was to be at 8120 Blue Ash Road, Cincinnati.

In April 1965 Trott wrote Boggild, then president of Crossbow, as follows:

> This outlines the basis on which Crossbow will undertake development work on a compact battery-operated tape recorder, designated by the code name CINCH, on behalf of the partnership owning all rights to same, known as Courier Enterprises.
>
> 1. Crossbow will develop CINCH to the working model stage, and as far beyond as available money may afford.
>
> 2. All work will be done on a time and materials basis, at the following labor rates:

Drafting	$ 6.00 per hour
Shop	$ 8.00 per hour
Design	$ 9.00 per hour
Development Engineer	$12.00 per hour
Chief Project Engineer	$20.00 per hour

It is my understanding that the above rates are competitive in the community to those charged by other shops engaged in similar work.

3. Crossbow will exert its best efforts to complete the assignment within the funds which Courier Enterprises has available for this purpose — $20,000.00 in total.

4. Crossbow will make every effort to complete the assignment within nine months from this date. If in the sole opinion of Courier Enterprises the progress of the project is unsatisfactory, it may remove the project from Crossbow responsibility after one year from this date.

5. Any equipment purchased by Crossbow solely for use in connection with this assignment, will be charged to the project and will become the property of Courier Enterprises.

6. All rights to patentable features, and to patents thereon, developed by Crossbow specifically in the course of development work on CINCH, will become the property of Courier Enterprises.

7. Courier Enterprises will be billed monthly for time and materials. No advance payments will be made. On occasion, however, Crossbow may request a cash advance when necessary to cover a substantial cash outlay by Crossbow, in the amount of this outlay.

8. The confidential nature of Crossbow's work on CINCH will be guarded insofar as possible by written security agreements signed by all Crossbow employees.

Please initial one copy of this letter and return it to me, as evidence of your agreement.

Crossbow carried out research and experimental work for Echo on the telephone-answering device upon the same basis.

Trott reported to the other partners in Echo as of March 1, 1966, as follows:

ECHO DEVELOPMENT CO.
MARCH 1, 1966 REPORT

This should be the last "progress report" on EAR prototype development.

Minor modifications to the instrument are being made by the consulting electronics engineer we retained to give the audio system a final check. These will complete all work on the device itself.

Patent counsel advises he will have the patent application completed this month.

Final costing and other paper work has been slowed by the absence due to illness of Mr. Boggild, but this, too, will be finished shortly.

Before March is out, therefore, we hope to present to the partnership the results of this development project and to secure agreement on the best manner in which to exploit it commercially.

[signature omitted]

In 1966 the telephone answering device and the tape recording device had been developed to the stage of being ready for sale. The partners hoped to license some manufacturers to build and market them. An application for a patent on the telephone answering device was filed in August 1966 and a patent was issued in November 1969 to R. Boggild. An application for a patent on the tape recording device was filed in November 1967 and a patent was issued in October 1969 to H. E. Hancock.

Crossbow also carried out research and development work on the leaf burning device as directed by Trott, upon the same cost basis as work for Echo and Courier. Altogether some 26 or more models were made and tried out in 1964 and thereafter. It was not developed to the point of being ready for sale in 1966.

In December 1965 patent counsel for Trott wrote him concerning the possibilities of securing patent protection

for the device, then referred to as a "leaf burner" or a "cyclone burner." Counsel noted several features which he thought were patentable. He wrote:

> This is a report of the supplementary patentability search which we have made with respect to your cyclone burner invention. As I understand it, the original search made in late 1964 was reported orally. I believe at that time you were advised that there was no chance for patent protection on the broad concept of a cyclone furnace used in conjunction with a vacuum cleaner type leaf collector mounted on a rolling platform.
>
> Your invention has progressed from the time of that report in the direction of improving the burning apparatus and you have improved it in three major respects. First, you mount a diverter at the top of a primary combustion chamber and create above it a secondary combustion chamber. The diverter has a central passageway projecting into the primary combustion chamber. Distribution vanes are secured to the top of the passageway and cause gases and entrained solids to be swirled in the secondary chamber.
>
> The second feature might be called your ignition structure. This comprises a grate at the lower end of the primary combustion chamber in combination with vanes extending across the lower end of the combustion chamber and spaced above the grate. A secondary air inlet passageway is connected to the lower end of the combustion chamber below the grate. In operation, a few glowing briquettes are placed on the grate and the secondary air causes them to glow brightly and ignite any solids contacting them. The vanes serve to break up the high velocity swirling air in the main combustion chamber, thereby creating in the space between the vanes and the grate a more or less gently flowing air which permits the solids to remain in contact with the briquettes for a sufficient length of time for their ignition.

> The third feature comprises the use of a cooling jacket surrounding the main and secondary combustion chambers with provision for bleeding secondary air from the main intake blower to the jacket. The important aspect of this feature is that a large volume of air is required to bring the solids into the burner but preferably that volume of air should be diminished before going into the combustion chamber for too much air will have an adverse effect on the burning. By taking secondary air from the main intake, you are able to provide (a) sufficient air to bring the solids into the system, (b) sufficient air for cooling, and (c) diminished air, as desired, in the combustion chamber.
>
> We are of the opinion that the Patent Office would be justified in granting protection to the features as outlined above. * * *
>
> I am not sure that you are ready to have the patent application prepared. If you are in the process of constructing a prototype utilizing your inventive features, you may wish to delay the preparation of the application until the completion of the prototype so that the application as filed will have the benefit of any improvements and/or greater understanding of the operation obtained through the creation of the prototype.

In February 1966 Trott's patent counsel expressed the opinion that the leaf burner invention had not been sufficiently reduced to practice to be patented. Counsel stated that examination of two models and discussion of tests made showed that neither performed satisfactorily enough to be a marketable product, that one burned too hot and the other did not handle fresh leaves well, and suggested that additional work would be necessary to modify the models for the continuous leaf burning function.

In February or March of 1966 Snow orally agreed to

join in a limited partnership venture to assist Trott in financing development of the trash or leaf burning device. He was aware that patent counsel had expressed an opinion that the device was unique. Snow thought it was or could be marketable and believed that no such equipment was then on the market. He had seen the models then developed.

On July 8, 1966, an agreement to form a limited partnership under the laws of Ohio was signed by Trott, as general partner, and Snow, Eugene W. Gilson, and Thomas J. Klinedinst as limited partners. Trott was also listed as a limited partner contributing

> All right, title and interest to a product concept, individually owned by David H. Trott, more particularly described as an incinerator designed for rapid consumption and burning of tree leaves and similar combustible materials.

Gilson contributed $20,000 for an 8 percent interest in the profits. Snow and Klinedinst each contributed $10,000 for a 4 percent interest. Trott had a 50 percent interest as general partner and 34 percent as limited partner.

The partnership was to be conducted under the name of "Burns Investment Company." Its principal office and place of business was to be at 8120 Blue Ash Road, Cincinnati. Its stated purpose was the development of "a special purpose incinerator for the consumer and industrial markets." The general partner was to have the sole right of management and conduct of the business. The partnership was to commence upon the execution and delivery of a Certificate of Limited Partnership in accordance with section 1781.02 of the Ohio Revised Code. Item 9 provided:

> 9. The liability of each Limited Partner for part-

nership debts shall in no event exceed the amount of contribution stated in this agreement and the certificate as having been made by each of them.

On April 3, 1967, the partners in Burns Investment Company signed an amendment contained the following new provision:

> Notwithstanding the above percentage of interest for each partner, if the partnership experiences a net loss for any fiscal year or period, which loss reduces the total credit balance in the capital accounts of the partnership to an amount which is lesser than the total amount of cash contributed by the Limited Partners to the partnership's capital, then such portion of the net loss which causes the reduction in the contributed cash capital shall be shared solely by the Limited Partners in the same proportion that the amount of their cash contribution bears to the total amount of cash contributed by all the Limited Partners. And while there exists any reduction in the Limited Partners' contributed cash capital and the partnership experiences a net profit in the following fiscal year or period, then such portion of the net profit which eliminated such reduction and restores the total cash contributed to capital shall be shared solely by the Limited Partners in the same proportions as is set out above for the sharing of any net loss.
>
> Nothing in this Item 4 is intended to modify or change the express language of Item 9 of this agreement.
>
> The modifications made herein to the General and Limited Partners' interest in the partnership's profits and losses shall be effective for the fiscal period ending December 31, 1966 and thereafter.

During 1966 Burns Investment Company paid the following bills from Crossbow for development work on the leaf burner:

Date of Bill	Amount		Description
7-15-66	$ 8,684.44	Work 2/65— 4/66	Shop, designers, engineers, materials
7-31-66	4,215.89	Work 5/66— 7/66	Shop, engineer, materials
12- 9-66	8,863.73	Work 8/66—11/66	Shop, designers, engineers, consultant, materials
12-30-66	12,500.00	Management, 500 hours	
12-30-66	2,516.38	Balance on services	
	$36,780.44		

The management services were by Trott, the engineering services largely by Boggild. The work involved building models. The work was done by Crossbow employees, including Trott.

In 1966 Burns had no manufacturing plant of its own, and had no office or separate facility. At the Crossbow shop Burns had no telephone. There was no sign on the building concerning Burns.

When the funds amounting to $40,000 contributed to the Burns partnership by the limited partners were exhausted, Trott financed further development of the leaf burner from his own funds.

After 1966 the design of the leaf burner was changed in some particulars.

Trott filed an application for a patent on the leaf burner on June 10, 1968. A patent was issued on March 3, 1970 to Trott.

Prior to 1970 a corporation was organized under the name of Burns Investment Corporation to produce and market the leaf burner. Many of the parts of the device were made under contract and Burns assembled it. It was called the "Trash-Away," and was advertised as for burning trash as well as leaves.

The leaf burning or trash burning device, as eventually patented, was a burning chamber which could be mounted on a 20-gallon trash can, or built in a larger size for use with a 55-gallon drum. It was constructed with two openings at the top, one for the admission of forced air, the other for exhaust of the combusted gases. The top layer of the material to be burned would be ignited and forced air from a blower would hasten the burning process. The air was introduced tangentially in such a way as to utilize the principles underlying the cyclone furnace, to establish a circular pattern of air movement taking advantage of centrifugal force to restrain still solid materials from reaching the exhaust port. It was novel in burning the materials from the top down. A regulator was provided to control the volume of air used.

Burns Investment Company filed a partnership return of income, Form 1065, for the taxable period August 1, 1966 to December 31, 1966. This reported the capital as of August 1 to be $40,000, and as of December 31, to be $3,219.56, showing a loss of $36,780.44, of which Snow's share was $9,195.11. The return reported no income and claimed expenses of $36,780.44 for research and development. It stated that the company "elects to expense in the current taxable year — its first taxable year — research and development expenses pursuant to Section 174 (a)."

Burns Investment Company filed a partnership return of income for the calendar year 1967 reporting no income and no expenses. The company filed a partnership return for 1968 reporting no income, expenses of $3,217.64 for research and development and $1.92 for bank service, leaving no assets at the end of the year.

Echo Development Company filed a partnership return of income, Form 1065, for the taxable period March 16 to December 31, 1965, reporting income of $823.27 from

interest, expenses of $79,990.87, and loss of $79,167.60. The expenses included $76,592.65 as Engineering Services, Research and Development Expense, and an election was made to expense these pursuant to section 174 (a). The schedule of partners' shares of income showed that Snow paid in $15,000 of capital and made a further contribution of $6,325, and that his share of the loss was $7,916.76. Echo filed a partnership return for 1966 reporting no income, expenses of $5,628.94, including research and development expense of $5,311.51. As a result of other capital contributions, the partnership had assets of $482.68 at the end of the year 1966. Echo filed a partnership return for 1967 reporting no income and no expenses.

Courier Enterprises filed a partnership return of income, Form 1065, for the taxable period March 22 to December 31, 1965, reporting income of $377.02 from interest, expenses of $20,054.13 and loss of $19,677.11. The expenses included $19,636 as Engineering Services, Research and Development Expense, and an election was made to expense these pursuant to section 174 (a). The schedule of partners' shares of income showed that Snow paid in $5,000 of capital and his share of the loss was $1,967.71. The assets at the end of 1965 were reported as $322.89. Courier filed a partnership return for 1966 reporting no income, with expenses of $15.44. Courier filed a partnership return for 1967 showing no income and no expenses.

The petitioners reported in their income tax return for 1966 salary of Snow, dividends, interest, capital gains and losses (resulting in a net loss), income and expenses of joint venture oil operations resulting in a net loss, expenses of a thoroughbred race horse operation from which no income was derived, and partnership income or losses (all shown as losses) in the following amounts:

Partnership	Loss
Echo Development Co.	$ 563.00
Courier Enterprises	2.00
Burns Investment Co.	9,195.00
Total	$9,760.00

In 1966 Snow devoted at least 50 hours per week to his duties as an officer of Procter & Gamble. He devoted approximately 3 to 4 hours weekly, on the average, to his thoroughbred race horse operation and one hour per week to his joint venture oil operation. He devoted some time to frequent meetings and conversations with Trott concerning the inventions of the telephone answering device, the tape recorder and the trash or leaf burner. He witnessed tests of the models of the leaf burner. He gave advice in 1965 and thereafter on the possible methods of promoting and marketing the three devices when they were developed to the stage of being saleable. His meetings with Trott were sometimes at the Crossbow shop, sometimes at restaurants, and sometimes at his home or Trott's. He discussed the devices with Trott in telephone conversations. He did not seriously consider abandoning the burner device at any time.

Burns Investment Company was not engaged in trade or business in 1966. The expenses for research and experimentation upon the trash burning device paid by Burns Investment Company in 1966 were not paid or incurred in connection with the trade or business of the partnership or of Snow.

Opinion

Edwin A. Snow invested $10,000 in 1966 in the limited partnership, Burns Investment Company, which was formed to develop and market a trash or leaf burning de-

vice invented by his friend Trott. The partnership, which was managed by Trott as the general partner, used the funds paid in by Snow and other limited partners to pay expenses of research and experimentation upon the invention. The partnership elected to deduct these expenses as permitted by section 174, Internal Revenue Code of 1954.[1] The partnership return of income reported no income, but a loss on account of expenses of $36,780.44 for research and experimentation for the taxable period ended December 31, 1966. The petitioners, in their return for 1966, claimed a deduction for Snow's share of this in the amount of $9,195. Respondent determined that the deduction was not allowable to Burns Investment Company under section 174 or any other provision of the Internal Revenue Code and disallowed the deduction claimed by the petitioners.

Section 174 (a) (1) permits a taxpayer to deduct research or experimental expenditures incurred or paid "in connection with his trade or business." The related Regulations provide in section 1.174-2 (a) (1) and (2)

> The term "research or experimental expenditures" as used in section 174, means expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense. * * *
>
> (2) The provisions of this section apply not only to costs paid or incurred by the taxpayer for research

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[1] SEC. 174. RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) Treatment as Expenses.—

(1) In General.—A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

> or experimentation undertaken directly by him but also to expenditures paid or incurred for research or experimentation carried on in his behalf by another person or organization (such as a research institute, foundation, engineering company, or similar contractor).

It is Snow's position that in 1966 he actively participated in the research and development as well as the overall management of three partnerships, Burns Investment Company, Courier Enterprises, and Echo Development Company, all of which were engaged in the trade or business of developing, perfecting and obtaining patents on new products; that as a member of such partnerships, he held for sale or licensing rights to products which had been developed and were ready for manufacturing; and that, by virtue of his participation in such partnerships, he was then engaged in the business of developing, perfecting and obtaining patents on new products for commercial exploitation.

Respondent concedes that the expenditures were for research and experimentation. The issue is whether they were paid or incurred by Snow "in connection with his trade or business," or the trade or business of Burns Investment Company.[2]

Whether an individual is engaged in a trade or business is essentially a question of fact to be determined from the evidence. *Higgins* v. *Commissioner* [41-1 USTC ¶ 9233], 312 U. S. 212 (1941). It is well settled that an individual may be engaged in two or more businesses. *George A.*

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[2] See and compare *Kenneth Reiner* [Dec. 27,488(M)], 24 T. C. M. 1005 (1965) for a discussion of section 174, its purposes and application.

Butler [Dec. 25,038], 36 T. C. 1097 (1961). An individual may be engaged in business by being a partner in a business. *Flood* v. *United States* [43-1 USTC ¶ 9259], 133 F. 2d 173 (C. A. 1, 1943). In *Deputy* v. *Du Pont* [40-1 USTC ¶ 9161], 308 U. S. 488, 499 (1940), Mr. Justice Frankfurter, in a concurring opinion joined in by Mr. Justice Reed, stated that "carrying on any trade or business, * * * involves holding one's self out to others as engaged in the selling of goods or services."

Petitioners cite *Cleveland* v. *Commissioner* [62-1 USTC ¶ 9142], 297 F. 2d 169 (C. A. 4, 1961), modifying [Dec. 24,237] 34 T. C. 517 (1960), and *Best Universal Lock Co.* [Dec. 27,585], 45 T. C. (1965).

In *Cleveland* v. *Commissioner, supra,* the taxpayer, an attorney, advanced funds to Hans Kerla, an inventor, for several years to finance research and development of an inorganic liquid binding material. In 1956 the parties signed an agreement to the effect that Kerla held the invention in trust, one-half for himself, one-half for Cleveland, that they would share equally in any proceeds, that Kerla would spend full time in active experimentation upon the invention and that Cleveland would advance expenses. The Court of Appeals concluded that Cleveland was thereafter engaged with Kerla in a joint venture in the trade or business of promoting the commercial development of the invention in which Cleveland owned a one-half interest, and the advances which he made thereafter were deductible under section 174.

Petitioners point out that Snow similarly advanced funds to a partner for research and experimentation for an interest in the profits expected to be derived.

We do not consider the Court of Appeals' decision in *Cleveland, supra,* as controlling in the present case. In

the cited case the inventor had been engaged in research and experimentation upon the invention for more than 10 years, and had applied for patents. The taxpayer had made extensive loans to Kerla to finance the research, had carried on negotiations leading to the transfer or proposed transfer of rights to prospective users of the invention, and had prepared legal documents concerning such transfers. Following all this the parties agreed that Kerla held the invention in trust, one-half for himself and one-half for Cleveland. We interpreted the agreement as constituting, at most, a sale by Kerla to Cleveland of a one-half ownership in the invention in consideration of prior moneys advanced, and not as a partnership or joint venture. The agreement did not seek to characterize advances made thereafter. We concluded that all advances made by Cleveland, both before and after the agreement, were loans to Kerla expendable by him as he saw fit. The Court of Appeals agreed that the advances prior to the agreement were in the nature of loans, but interpreted the agreement as creating a joint venture and held that expenditures for research and development made thereafter were deductible. The present case is different. In 1966 Trott had hardly begun experimentation upon the trash burner, the application for a patent was not made until 1968, the advance of funds was made only in 1966 and no effort to market or sell the device was attempted until several years later. The partnership, Burns Investment Company, had as yet no trade or business in 1966 and the expenditures paid in that year were not "paid in connection with" its trade or business but were preparatory to a business which came into existence after the taxable year. *Morton Frank* [Dec. 19,702], 20 T. C. 511 (1953). *George C. Westervelt* [Dec. 15,850], 8 T. C. 1248 (1947); *Frank B. Polachek* [Dec. 20,453], 22 T. C. 858 (1954); *Richmond Television Corporation* v. *United States* [65-1 USTC ¶ 9395], 345 F. 2d

901 (C. A. 4, 1965); *Mayrath* v. *Commissioner* [66-1 USTC ¶ 9250], 357 F. 2d 209 (C. A. 5, 1966), affirming [Dec. 26,624] 41 T. C. 582 (1964); *John F. Koons* [Dec. 24,760], 35 T. C. 1092 (1961).

In *Best Universal Lock Co., supra,* a corporation in the business of making locks undertook research and experimentation upon an isothermal air compressor. Respondent contended that expenses of such research were not deductible because they were unrelated to the corporation's lock business. In holding the project an integral part of the corporation's trade or business, we said, at p. 10:

> We find nothing in the legislative history of section 174 to support respondent's contention that the section was not meant to cover research and development expenses where a corporation was seeking to develop a new product unrelated to its past line of products. An express purpose of the new section in the 1954 Internal Revenue Code was to encourage taxpayers to carry on research and experimentation, S. Rept. No. 1622, 83d Cong., 2d Sess., p. 33, and we think respondent's limited approach would prove inimical to such congressional purpose.

In *Best Universal Lock Co., supra,* the taxpayer corporation was already in a going business when it undertook research and experimentation upon the new and different item. In the present case the Burns partnership was experimenting upon its only invention and was not as yet engaged in a business as to that item.

Snow contends that because, in addition to Burns he was also a participant in Trott's other partnerships Courier and Echo, which in 1966 had inventions ready for sale or licensing, he, and Trott as well, were in the trade or business of inventing, developing and marketing patentable products, and that although the Burns invention was not

completed, it was a similar product, the research expenses of which should be deductible in accordance with the principle of *Best Universal Lock Co., supra.*

We note that there were no sales nor attempts to sell by Burns in 1966, 1967 nor 1968. There were no goods held for sale by Burns in the taxable year 1966. And if the other partnerships, Courier and Echo, and the inventions they developed may be considered in this connection there were no sales by either of them in 1966 nor 1967. While Snow said these inventions were ready for sale or licensing, there is no evidence that any effort was made to sell them. Snow testified that such a sale was Trott's function. Trott did not mention any attempt to offer them for sale.

In *Industrial Research Products, Inc.* [Dec. 26,191], 40 T. C. 578 (1963), an individual taxpayer, Knowles, claimed a deduction for expenses of a business he allegedly carried on from his home as a consulting engineer. He was a corporate executive receiving salary income. He contended that deduction of such expenses was justified by reason of his carrying on a business as an inventor. While he testified that some patents had been issued to him it was not clear that he worked on these inventions in the taxable year. We said:

> At any rate the mere working on inventions during the year in question with no activity of offering them for sale or license, would be insufficient to show engagement in an inventing business.

In *Stanton* v. *Commissioner* [68-2 USTC ¶ 9516], 399 F. 2d 326 (C. A. 5, 1968), affirming a Memorandum Opinion of this Court [Dec. 28,516(M)], the taxpayer sought to deduct research and experimental expenditures incurred in the development of a "storm proof" boat. The Court of Appeals concluded that the taxpayer's efforts as an in-

ventor lacked that degree of continuity and regularity that is essential before an activity can be found to constitute a trade or business. The taxpayer's efforts, spread over a number of years, were irregular and sporadic; and his revenue was neglible.[3]

Although a taxpayer may be in the business of doing research and experimentation, or of being an inventor, it is necessary that this be related to the development or improvement of existing products or services, or to new products or services in connection with a going trade or business.

In *John F. Koons, supra,* the taxpayer purchased an invention and contracted with a laboratory to develop it. He claimed a deduction under section 174 for the amount paid to the laboratory. We held that these expenses were not made in connection with any existing trade or business of the taxpayer and that the undertaking involved was not in itself an existing business in the taxable year. We said, pp. 1100-1101:

> It is our view that section 174 (a) (1) applies to expenditures for research and experimentation in connection with an existing business to which such research and development is proximately related, such as the development or improvement of its existing products or services, or the development of new products and services in connection with such trade or business. We do not suggest that these generalities are all-inclusive. In the instant case, however, there was no such existing trade or business. The research and experimentation was no doubt in anticipation of the organizing of a business to make business use of

[3] *Cf. Myron E. Cherry* [Dec. 28,487(M)], 26 T. C. M. 557 (1967); *Charles H. Schafer* [Dec. 26,828(M)], 23 T. C. M. 927 (1964); *William S. Scull, II* [Dec. 26,936(M)], 23 T. C. M. 1353 (1964).

an end product when it reached the point of commercial acceptability. At the time the invention was bought by petitioner, however, it was in a preliminary laboratory state, and petitioner entered into the so-called Development Contract in part, at least, to get the benefit of research specialists. He went no further than this in 1955, however. It is our view that this activity was preliminary to the coming into existence of a business, and did not reach the stage of an existing business in the year in question within the meaning of section 174 (a) (1). The research and development expenditures could not be "in connection with" a business which did not exist.

In the *Koons* case we held that the taxpayer was not yet in business but was merely preparing to enter a business which would commercially exploit a patent, so that the costs of developing the patent were not currently deductible.

The partnership Burns Investment Company in 1966 was not holding itself out to others as engaged in the selling of goods or services. Its research and experimentation was not related to the development or improvement of existing products or to new products in connection with an existing trade or business. *Cf. Best Universal Lock Co., supra.* It follows that Burns was not engaged in carrying on a trade or business in 1966 and that the expenditures for research and experimentation here involved were not paid "in connection with" the trade or business of the partnership or of Snow.

Decision will be entered for the respondent.

No. 72-2019

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Appeal from the Decision of the United States Tax Court.

EDWIN A. SNOW AND HELEN B. SNOW,
Petitioners-Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Decided and Filed July 17, 1973.

Before: EDWARDS and MILLER, Circuit Judges, and LAMBROS,* District Judge.

EDWARDS, Circuit Judge. Petitioners (joint taxpayers) seek review of the decision of the United States Tax Court, reported at 58 T.C. No. 60 (June 30, 1972). The Tax Court determined a deficiency of income taxes due from taxpayers in the amount of $6,247 for the taxable year of 1966 by denying that a deduction of $9,195.11 claimed by Edwin A. Snow was properly claimed as research and experimental expenditures within the scope of Section 174 of the Internal Revenue Code of 1954. In applicable part this section says:

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* Honorable Thomas D. Lambros, United States District Judge, Northern District of Ohio, sitting by designation.

§ 174. Research and experimental expenditures

(a) Treatment as expenses—

(1) In general.—A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction. 26 U.S.C. § 174 (a) (1) (1970).

The deductions claimed were for proportionate loss suffered by Snow as a partner in the Burns Investment Company, which was engaged in the research and development of a trash burner device.

Snow invested $10,000 in the Burns Investment Company and had made similar investments in two other companies (Courier Enterprises and Echo Development Company) in which an inventor named Trott was the actual principal. In relation to Burns Investment, however, Trott invested no cash. As a consequence, Trott was not entitled (under his agreement with other shareholders) to share in any tax deduction derived from the expenditure by Burns of some $36,000 on seeking to develop the trash burner in 1966, the year in which the company was formed.

The company filed a return electing to expense the research and development expenses pursuant to Section 174 (a), and claimed a loss of $36,780.44, of which appellant Snow's share was $9,195.11.

It is undisputed that Burns Investment Company was just beginning its operation in 1966 and did not sell or offer to sell any of its products during that year. Nor did it have a patent issued or pending on the trash burner, or any income from sale of licenses or any other source. Trott's first patent application on the trash burner was filed in 1968 and a patent was issued in 1970. The Tax Court held on these facts that Burns Investment was not

engaged in trade or business in 1966 and that the expenditures were not "paid in connection with" its trade or business.

The Tax Court also held that Snow was not employed in the trade or business of inventing or development of inventions because of his investment in Burns and similar investments in two other small companies similarly organized by Trott to develop two other devices.

Appellants, including amici curiae representing small business and inventors, protest the unfairness of this decision. Snow claims that he is engaged in trade or business in relation to his investments in these several companies organized to develop and exploit inventions. He also claims that his participation in Burns Investment Company by organizational management and asserted technical suggestions pertaining to the invention constituted his participating in a trade or business. In addition, he asserts (and here the amici curiae join) that any small business must start somewhere and that refusal to allow first-year development expenditures is inconsistent with the congressional purpose in adoption of Section 174, which purpose was stated in part in the Congressional Record as follows:

> [T]o precent tax discrimination between large businesses having continuous programs of research and small or *beginning* enterprises. . . . 97 Cong. Rec. 4326A (1951) (Remarks of Rep. Camp). (Emphasis added.)

One other fact should be added. Snow had an income in 1966 at his principal occupation as an Executive Vice President of Procter & Gamble in excess of $200,000. As a consequence, if Section 174 applied, his investment in Burns was made as a high bracket taxpayer. Thus, as is so frequently true, two laudable public purposes are in direct conflict: 1) the Congressional purpose of stimulating

research and development, including research and development on the part of inventors and small businessmen, and 2) the desirability of strict interpretation of tax laws so as to prevent unintended tax shelters.

The Tax Court founded its decision of this case on the conclusion that neither basis of Snow's claim for deductions constituted expenditures "paid in connection with a trade or business" as that phrase had been construed at the time of the Congressional enactment of Section 174.

We agree with the Tax Court that "the issue is whether they [the expenditures for research and experimentation] were paid or incurred by Snow 'in connection with his trade or business' " or the trade or business of Burns Investment Company.

The best known definition of these critical terms is that of Mr. Justice Frankfurter in a concurring opinion in *Deputy* v. *DuPont*, 308 U.S. 488, 499 (1940), where he said, " '. . . carrying on any trade or business,' . . . involves holding one's self out to others as engaged in the selling of goods or services." This definition was quoted and adopted by the Fourth Circuit. *Helvering* v. *Highland*, 124 F.2d 556 (4th Cir. 1942). The Fifth Circuit employed similar language, but added that "extensive activity over a substantial period of time" was required. *Stanton* v. *Commissioner*, 399 F.2d 326, 329 (5th Cir. 1968).

It seems clear to us, as it did to the Tax Court, that Burns Investment Company in 1966 was not holding itself out to others as being engaged in the selling of goods and services. It was engaged, of course, in experimental work preparatory to going into business, but the expenditures were not made (as required by Section 174) "in connection with [its] trade or business," since as of 1966 it had no product to offer.

In a somewhat different fact situation, Judge Sobeloff of the Fourth Circuit, construed the language "carrying on any trade or business" in the context of Section 162 (a) dealing with ordinary and necessary business expenses:

> The uniform[6] teaching of these several cases is that, even though a taxpayer has made a firm decision to enter into business and over a considerable period of time spent money in preparation for entering that business, he still has not "engaged in carrying on any trade or business" within the intendment of Section 162 (a) until such time as the business has begun to function as a going concern and performed those activities for which it was organized.[7]

Applying this rule, we are of the view that there was no basis in the evidence for a charge permitting the jury to find that the taxpayer was in business during the period in question. We are of the opinion, therefore, that the District Court was in error in failing to hold as a matter of law that Richmond Television was not in business until 1956, when it obtained the license and began broadcasting. Until then there was no certainty that it would obtain a license, or that it would ever go on the air. Since all of the expenditures underlying the disputed deductions were made before the license was issued and broadcasting commenced, they are "pre-operating expenses," not deductible under section 162 (a).

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[6] Southeastern Express Co., 19 B.T.A. 490 (1930) the only authority *contra*, has not been followed or even mentioned in later Tax Court cases.

[7] Compare concurring opinion of Mr. Justice Frankfurter, Deputy v. DuPont, 308 U.S. 498, 499, 60 S.Ct. 363, 369, 84 L.Ed. 416 (1940), "'• • • carrying on any trade or business,' • • • involves holding one's self out to others as engaged in the selling of goods or services." See also the following cases construing the terms "trade or business" as used in section 174(a) (1), Internal Revenue Code of 1954, 26 U.S.C.A. § 174(a) (1) (1955), dealing with research and experimental expenses: Koons v. Commissioner of Internal Revenue, 35 T.C. 1092 (1961), "'trade

> or business' presupposes an existing business with which the taxpayer is directly connected"; Mayrath v. Commissioner of Internal Revenue, 41 T.C. 582 (1964), "'trade or business,' is used in the practical sense of a going trade or business."
>
> *Richmond Television Corp.* v. *United States*, 345 F.2d 901, 907 (4th Cir. 1965).

Similarly, in our instant case we hold that the expenditures sought to be deducted by Burns Investment Company in 1966 were "pre-operating" expenses and not deductible under Section 174. We cannot hold that the comment previously quoted from Representative Camp concerning "beginning enterprises" demonstrates a Congressional intent to set aside the settled interpretation of the language "trade or business" as used in Section 174.

Appellants rely upon *Cleveland* v. *Commissioner*, 297 F.2d 169 (4th Cir. 1961). We are by no means certain that *Cleveland* involved any dispute over whether the joint enterprise therein concerned was engaged in a trade or business. If, however, it be read as in conflict with our view in this case, we prefer the logic of the later Fourth Circuit holding in *Richmond Television Corp.* v. *United States, supra,* to the Fourth Circuit's earlier holding in *Cleveland.*

Snow also contends that he should be allowed to deduct these same expenditures (even if Burns is not held to be in business in 1966) because he was himself engaged in the business of developing inventions.

Concerning this contention of Snow's, the Tax Court said:

> Snow contends that because, in addition to Burns, he was also a participant in Trott's other partnerships, Courier and Echo, which in 1966 had inventions ready for sale or licensing, he, and Trott as well, were in the trade or business of inventing, developing and marketing patentable products, and that although the

Burns invention was not completed, it was a similar product, the research expenses of which should be deductible in accordance with the principle of *Best Universal Lock Co., supra.*

We note that there were no sales nor attempts to sell by Burns in 1966, 1967 nor 1968. There were no goods held for sale by Burns in the taxable year 1966. And if the other partnerships, Courier and Echo, and the inventions they developed may be considered in this connection there were no sales by either of them in 1966 nor 1967. While Snow said these inventions were ready for sale or licensing, there is no evidence that any effort was made to sell them. Snow testified that such a sale was Trott's function. Trott did not mention any attempt to offer them for sale.

* * *

In *Stanton* v. *Commissioner,* 399 F. 2d 326 (C.A. 5, 1968), affirming a Memorandum Opinion of this Court, the taxpayer sought to deduct research and experimental expenditures incurred in the development of a "storm proof" boat. The Court of Appeals concluded that the taxpayer's efforts as an inventor lacked that degree of continuity and regularity that is essential before an activity can be found to constitute a trade or business. The taxpayer's efforts, spread over a number of years, were irregular and sporadic, and his revenue was negligible.[3]

Although a taxpayer may be in the business of doing research and experimentation, or of being an inventor, it is necessary that this be related to the development or improvement of existing products or services, or to new products or services in connection with a going trade or business.

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[3] Cf. *Myron E. Cherry,* 26 T.C.M. 557 (1967); *Charles H. Shafer,* 23 T.C.M. 927 (1964); *William S. Scull, II,* 23 T.C.M. 1353 (1964).

While it is true that a taxpayer may be engaging in more than one business, *George A. Butler,* 36 T.C. No. 1097 (Sept. 19, 1961), Snow's activities as shown by this record were clearly not such as to warrant his claiming to be engaged in the business of inventing. A somewhat less unsubstantial claim might be an assertion that he was engaged in the business of development of inventions by investment. In this connection the record shows that he had made minority stockholder investments in three companies ($10,000 in Burns, $5,000 in Courier, and $15,000 in Echo). In 1966 none of these companies had a product for sale to the public, although Courier and Echo had each developed a device to the point where they were available for licensing.

If investing in development of inventions could properly be held to be carrying on a trade or business, we would agree with the Tax Court that Snow's investment activities in relation to these three companies were not sufficiently continuous or regular enough when taken together to represent his engaging in carrying on a trade or business.

We believe, however, that the Supreme Court decision in *Whipple* v. *Commissioner,* 373 U.S. 193 (1963), forecloses our consideration of Snow's claim to be engaging in a trade or business as an investor in inventions. In *Whipple* the taxpayer was engaged full time (not sporadically in time off from a $200,000 executive post) in management of his investments in corporations in which he had a *majority* interest. He claimed a deduction for a bad debt on an unpaid loan he had made to one of the corporations which went bankrupt. The Supreme Court rejected the bad debt deduction under Section 23(k)(1) because it held taxpayer's activities in investing and managing his investments did not constitute a trade or business.

The Court said:

Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation. Even if the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own business and those actually arising from activities peculiar to an investor concerned with, and participating in, the conduct of the corporate business.

If full-time service to one corporation does not alone amount to a trade or business, which it does not, it is difficult to understand how the same service to many corporations would suffice. To be sure, the presence of more than one corporation might lend support to a finding that the taxpayer was engaged in a regular course of promoting corporations for a fee or commission, see Ballantine, Corporations (rev. ed. 1946), 102, or for a profit on their sale, see *Giblin* v. *Commissioner,* 227 F. 2d 692 (C. A. 5th Cir.), but in such cases there is compensation other than the normal investor's return, income received directly for his own services rather than indirectly through the corporate enterprise, and the principles of *Burnet, Dalton, du Pont* and *Higgins* are therefore not offended. On the other hand, since the Tax Court found, and the petitioner does not dispute, that there was no intention here of developing the corporations as going businesses

> for sale to customers in the ordinary course, the case before us inexorably rests upon the claim that one who actively engages in serving his own corporations for the purpose of creating future income through those enterprises is in a trade or business. That argument is untenable in light of *Burnet, Dalton, du Pont* and *Higgins,* and we reject it. Absent substantial additional evidence, furnishing management and other services to corporations for a reward not different from that flowing to an investor in those corporations is not a trade or business under § 23 (k) (4). We are, therefore, fully in agreement with this aspect of the decision below. *Id.* at 202-03. (Footnotes omitted.)

Under this holding we feel compelled to affirm the denial of the deductions sought by Snow as a result of his investment and managerial activities in the three companies concerned.

For the reasons set forth above, we affirm the judgment entered by the Tax Court. We have not sought to distinguish between those aspects of the Tax Court's decision which we affirm because they are findings of fact which are not clearly erroneous, *Commissioner* v. *Duberstein*, 363 U.S. 278, 289-91 (1960), and those which we agree with as conclusions of law since we would affirm all relevant findings and conclusions on either basis.